PENSIONS
INVESTMENTS
LIFE INSURANCE

Irish Life | 75 Years of Experience

# *IRISH LIFE INVESTMENT MANAGERS*

## Monthly Markets Mindshare – January 2016

**Seán Haverty**
**Investment Manager, Irish Life Investment Managers**

# IRISH LIFE INVESTMENT MANAGERS




- **Only Irish winner at 2014 European Pension Awards and**
- **Only Investment Manager to win two awards**
- **Irish Pension Awards 2015 – 'Investment Manager of the Year' – for the third year running**

# CONTENT

# ASSET WATCH

- **Equities**

  The global economy is experiencing a slow growth recovery, modest by levels evident pre-crisis and lower than the typical cyclical recovery. While periodic global growth concerns have been evident, recently highlighted by concerns over growth in China, growth in developed economies remains resilient. The global economy should continue to generate positive growth, leading to positive earnings growth. Global central banks remain supportive, committing to keep interest rates relatively low, facilitated by low levels of inflation. While a rate tightening cycle has begun in the US and is expected in the UK, rate rises are expected to be gradual. G4 (Eurozone, US, Japan, UK) central banks balance sheets continue to expand given ongoing asset purchases by the ECB and Bank of Japan. Relative valuations remain supportive of global equities, particularly against cash and bonds, providing upside in equity markets. While mid single digit gains in equities are expected in 2016, increased volatility is likely to remain as political events and economic and monetary developments give rise to fluctuations in markets from time to time.

- **Bonds**

  While absolute levels of yields in core Eurozone markets are low, ECB policies, notably the sovereign bond purchase programme, probably cap upside in yields and support further narrowing of peripheral spreads in the medium term. However the rise in European inflation through 2016 due to base effects and the impact of rising rates in the US could lead to slightly higher core yields and marginally negative returns from sovereign bonds in 2016.

- **Property**

  The Irish property market has been strong with activity at record levels, which are expected to remain high given the weight of buyer interest. Yields have compressed, led by offices and has been supported by the yield gap against bonds. Prime office yields are expected to begin to stabilise with further falls expected in the retail and industrial sectors. Rental growth has been strong in the office sector due to limited supply and is expected to continue while rental growth can recover in the retail and industrial sectors after recent signs of stabilisation. With an overall sector yield of around 5%, Irish property is expected to generate double digit returns pa over the next two years.

- **Cash**

  Cash returns are expected to remain low through 2016.

# Market Developments in December

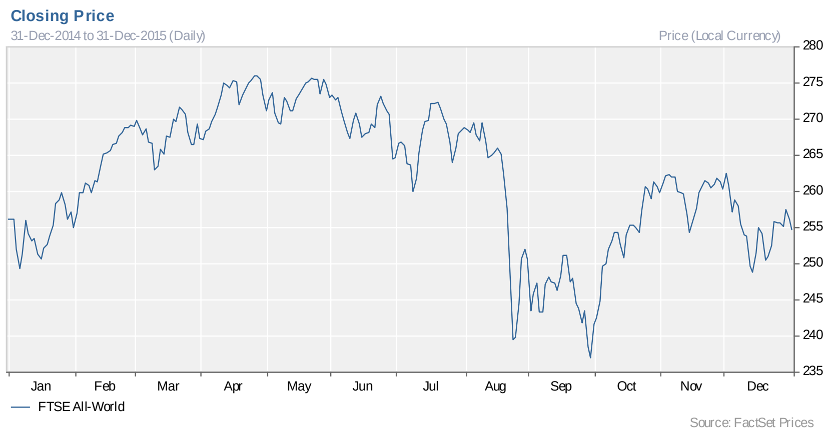
- Global equities fell -2.0% (-4.4% in €).
- Eurozone > 5 year bonds fell -1.6% following disappointment over the policy measures announced by the ECB. German 10 yields rose to 0.63% while Spanish and Italian 10 year spreads against Germany widened to 114bps and 97bps respectively
- The Euro rose to 1.086 against the US$ following the smaller than expected stimulus from the ECB
- Commodities fell -7.3% (-9.9% in €) as Brent oil fell -16.4% as OPEC members failed to agree to a cut in production
- The ECB cut the deposit rate by -0.1% to -0.3% and extended the length of asset purchases by six months to at least March 2017
- While significant in their own right, these announcements by the ECB were disappointing relative to investor expectations and led to weakness in equities and bonds, particularly in Europe, and a rebound in the Euro
- In contrast, the US Fed met expectations when announcing a 0.25% increase in US interest rates, the first in over nine years and exactly seven years after rates were reduced to historic lows. The Fed justified the rate rise by its increasing confidence in the US economic backdrop
- The tone of Fed commentary associated with the rate rise was relatively reassuring as the Fed emphasised the pace of rate rises in the current cycle would be gradual, despite its forecasts for the level of the Fed funds rate in coming years being slightly higher than investor expectations
- The inconclusive Spanish general election result contributed to uncertainty and fears over the potential for rising political tensions across the Eurozone

# Market Performance

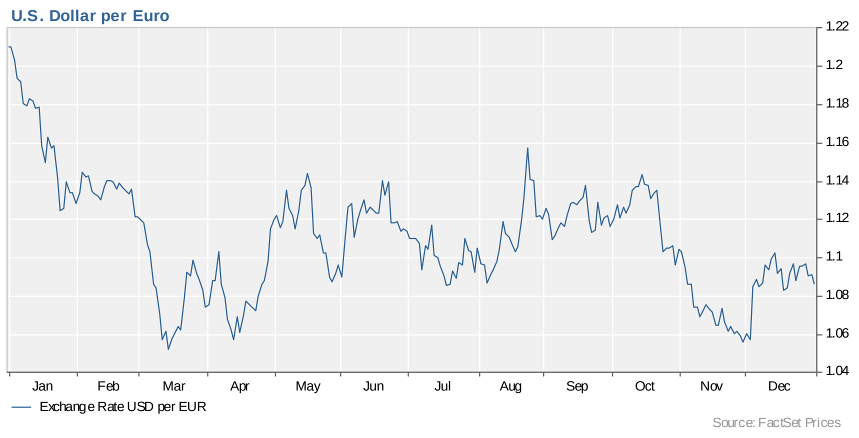
| Markets In December | Local Returns | Euro Return |
|---|---|---|
| Ireland | -0.7 | -0.7 |
| UK | -1.7 | -6.5 |
| US | -1.7 | -4.4 |
| North America | -1.8 | -4.7 |
| Europe | -4.5 | -4.6 |
| Japan | -2.1 | -2.5 |
| Pacific | 0.9 | -2.2 |
| Emerging Markets | -1.0 | -4.9 |
| World | -2.0 | -4.4 |
| EMU Govt Bonds >5yr | -1.6 | -1.6 |
| Commodities | -7.3 | -9.9 |

| Markets YTD | Local Returns | Euro Return |
|---|---|---|
| Ireland | 33.6 | 33.6 |
| UK | -0.8 | 4.4 |
| US | 1.0 | 12.5 |
| North America | 0.5 | 10.9 |
| Europe | 8.7 | 10.9 |
| Japan | 11.5 | 23.8 |
| Pacific | -2.7 | 0.7 |
| Emerging Markets | -5.4 | -4.9 |
| World | 1.9 | 9.6 |
| EMU Govt Bonds >5yr | 2.0 | 2.0 |
| Commodities | -32.9 | -25.2 |

### Equities Lower as ECB Disappoints the Market




### Euro Rebounds as ECB Flatters to Deceive




FTSE®", "FT-SE®", "Footsie®", "FTSE 4Good®" are trademarks of the Exchange and the FT and are used by FTSE under license.



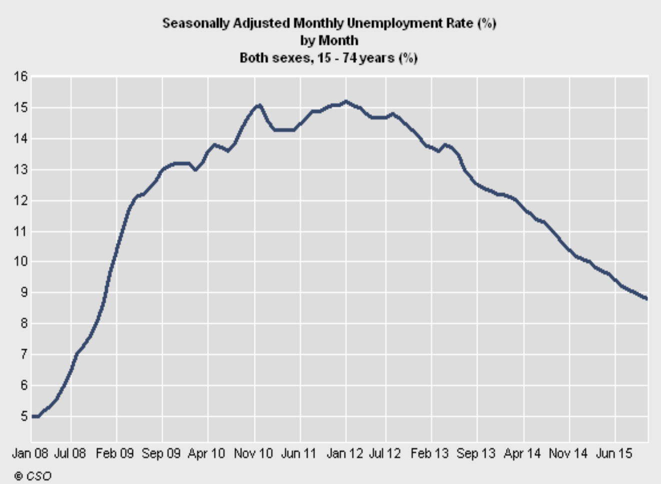
Irish Life | 75 Years of Experience

# Economy in Focus - Ireland

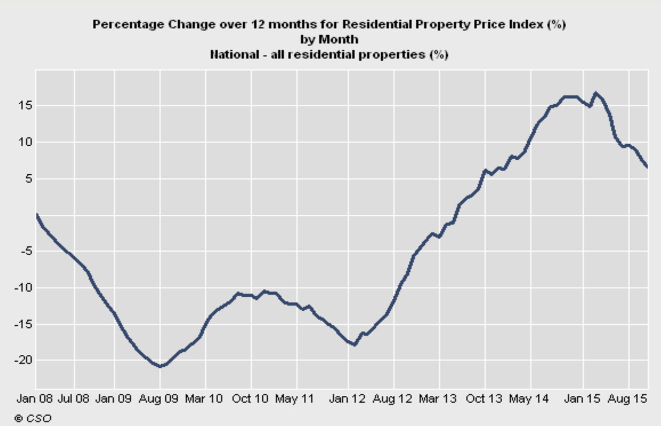
## Economy

- Economic releases generally remained positive.
- Q3 GDP rose 1.4% q/q or 7.0% y/y. Consumption rose 0.7% q/q and 3.6% y/y. Investment rose 4.9% q/q and 35.8% y/y, mainly due to R&D by multinational corporations. Domestic investment activity was also strong with housing investment up 11% y/y and construction up 3.3% y/y. Stripping out multinationals, GNP fell -0.8% q/q but rose 3.2% y/y
- Seasonally adjusted numbers on the Live Register fell 2,200 to 330,000. Unemployment fell 0.4% to 8.9%
- Industrial production remains volatile, rising 3.4% m/m and 17.1% y/y
- The seasonally adjusted monthly trade surplus rose €990m to €4,428m with exports up 17.5% m/m and imports up 10.2% m/m
- The composite PMI rose 2.5 to 60.2; services rose 3.5 to 63.6; manufacturing PMI slipped -0.3 to 53.3
- National residential property prices fell -0.5% m/m but were up 6.5% y/y. Dublin prices fell -1.3% m/m but were up 3.3% y/y. Prices outside Dublin rose 0.2% m/m and 9.6% y/y
- CPI fell -0.3%  m/m and -0.2% y/y
- Exchequer returns to the end of November remained positive with a budget surplus of €343m compared to a deficit of €5,759m at the same time in 2014. Tax revenues were up 10% y/y at €41,972m and were €2,942m or 7.5% ahead of forecasts mainly due to corporate taxes. Net voted expenditure was €11m below target. The returns suggest the official budget deficit targets of 2.1% and 1.2% GDP in 2015/16 will be beaten

**Irish Unemployment Rate Continues to Fall**




**Pace of Residential Property Prices Slows**



# Economy in Focus - Eurozone

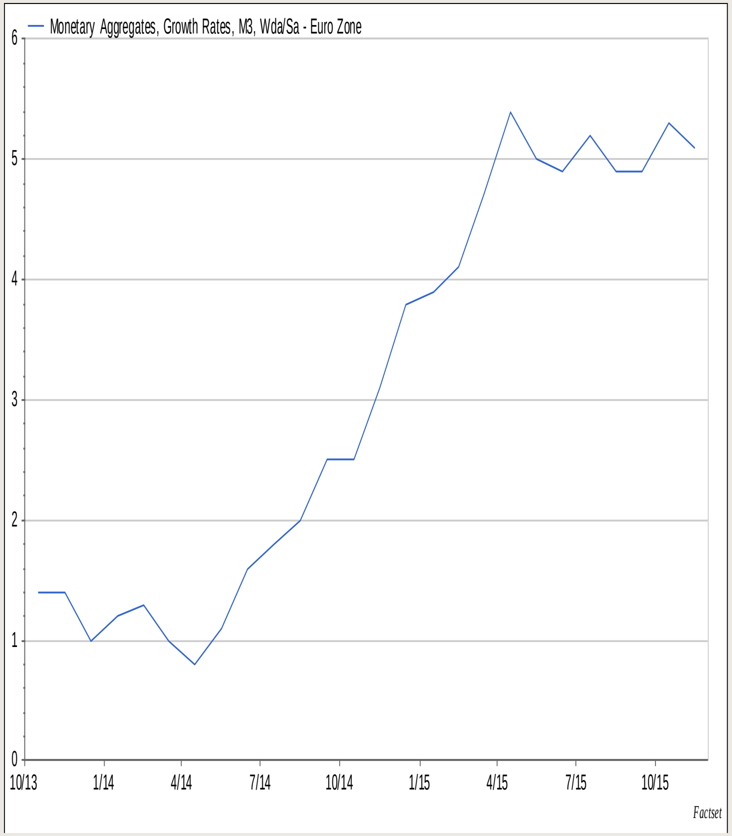
## Economy

- Data was mixed
- The composite PMI slipped -0.2 to 54.0. ZEW expectations rose 5.6 to 33.9; Sentix business sentiment rose 0.6 to 15.7
- Industrial production rose 0.6% m/m; retail sales fell -0.1% m/m; consumer confidence rose 0.2 to -5.7; M3 money supply growth slipped 0.2% to 5.1% y/y
- CPI rose 0.2% y/y; core inflation ex food and energy rose 0.9% y/y
- The German composite PMI fell -0.3 to 54.9; the IFO business climate fell -0.3 to 108.7; retail sales fell -0.4% m/m; consumer confidence rose 0.1 to 9.4; industrial production rose 0.2% m/m; factory orders rose 1.8% m/m
- The French composite PMI fell -0.7 to 50.3; business confidence fell -1 to 101; industrial production rose 0.5% m/m; consumer spending fell -1.1% m/m
- In Spain the composite PMI rose 1.2 to 56.2; industrial production rose 0.2% m/m; retail sales rose 3.3% y/y
- The Italian composite PMI rose 0.4 to 54.3; industrial production rose 0.5% m/m; retail sales fell -0.3% m/m; consumer confidence fell -0.8 to 117.6

## Interest Rates

- While the ECB announced a significant increase in the level of stimulus, it was less than expected by investors
- The ECB cut the deposit rate by -0.1% to -0.3% and extended the asset purchase programme out to at least March 2017
- Regional and local government debt is to be included in asset purchases and existing debt will be reinvested as it matures
- There was no increase in the level of monthly asset purchases of €60bn
- It appeared President Draghi was unable to convince all council members to vote for a more comprehensive package
- It was argued the improvement in the Eurozone economic backdrop did not warrant additional measures but President Draghi left open the possibility of further measures in the future if needed

**Eurozone M3 (Money Supply) Growth Slows**



# Economy in Focus – U.S.

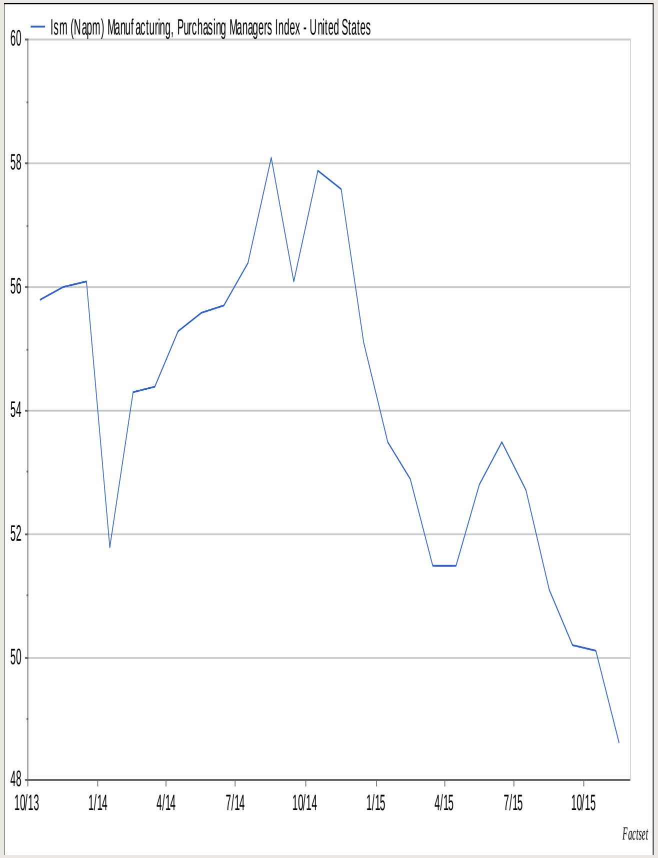
**Economy**

- U.S. economic data was a touch disappointing
- Q3 GDP was revised down 0.1% to 2.0% annualised mainly due to lower inventory build
- ISM manufacturing fell -1.5 into contractionary territory at 48.6; services fell -3.2 to 55.9; the composite PMI fell -2.4 to 53.5; small business confidence fell -1.3 to 94.8
- Non-farm payrolls rose 211,000; unemployment was unchanged at 5.0%; average hourly earnings rose 2.3% y/y; industrial production fell -0.6% m/m; factory orders rose 1.5% m/m
- Headline retail sales rose 0.2% m/m; consumer confidence rose 3.9 to 96.5
- CPI rose 0.5% y/y; core CPI ex food and energy rose 2.0% y/y
- Durable goods orders were unchanged m/m; orders ex transport fell -0.1% m/m; capital goods shipments fell -0.5% m/m
- House prices in the top 20 cities rose 0.8% m/m and 5.5% y/y; housing starts rose 10.5% m/m; new home sales rose 4.3% m/m while existing home sales fell -10.5% m/m

**Interest Rates**

- The Fed raised interest rates for the first time in nine years by 0.25% to a range of 0.25/0.5% on the Fed funds rate
- The tone of the statement and press conference was dovish with the Fed emphasizing the pace of rises will be gradual
- Future rate rises will be data dependent, mainly on inflation
- Fed forecasts for rates in future years were higher than expected at 1.4% by end 2016, 2.4% in 2017 and 3.3% in 2018
- The Fed expressed confidence in the US economic outlook

**U.S. ISM (Institute of Supply Management) Manufacturing Index Falls Below 50**



# Economy in Focus - U.K.

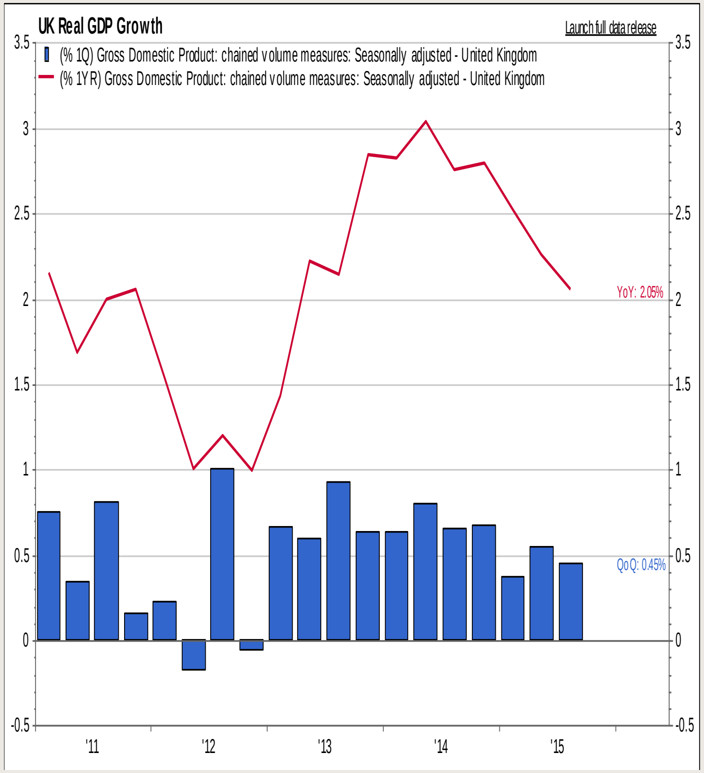
## Economy

- U.K. data was slightly disappointing, mainly related to revisions to GDP data
- Q3 GDP was revised down to 0.4% q/q and 2.1% y/y due to lower government spending, lower investment and smaller stock build. Q2 GDP was also revised down due to changes to inventory drawdown
- The composite PMI rose 0.4 to 55.8; manufacturing was down -2.8 to 52.7; services rose 1.0 to 55.9
- Headline retail sales rose 1.7% m/m and 5.0% y/y; consumer confidence rose 1 to 2
- Unemployment fell 0.1 to 5.2%; numbers employed grew 207,000 over three months from 177,000 previously; average weekly earnings ex bonuses rose 2.0% y/y from 2.4% previously
- Industrial production rose 0.1% m/m and 1.7% y/y; construction output rose 0.2% m/m and 1.0% y/y
- The Halifax house price index fell -0.2% m/m but was up 9.0% y/y
- CPI rose 0.1% y/y

## Interest Rates

- The BoE voted 8:1 to leave policy unchanged, again suggesting little urgency to raise rates currently
- The minutes indicated there was little news which impacted views on the outlook for either the domestic or global economy
- If anything there was a slightly more dovish tone to the minutes with the recent fall in the oil price and levelling off in U.K. wage growth being highlighted
- Consensus expectations are for the first U.K. rate rise to occur in Q4 this year

### U.K. GDP Revised Down



# Economy in Focus - Asia

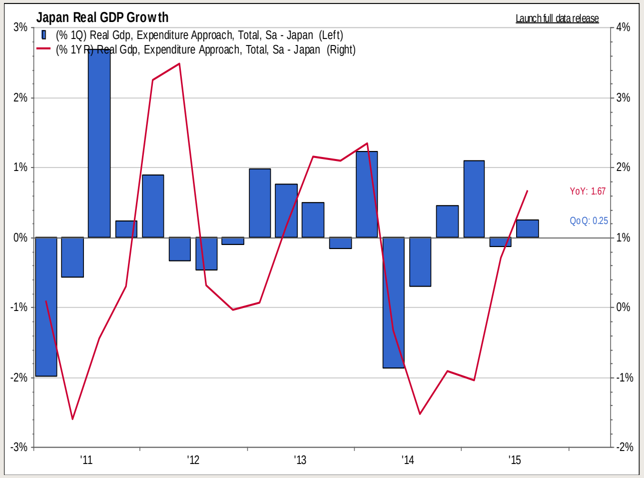
## Japanese Economy

- Economic releases were somewhat mixed
- Q3 GDP was revised up from a contraction to a positive 0.3% q/q or 1% annualised; business spending was revised up from -1.3% q/q to +0.6% q/q; the contribution from inventories was revised from -0.5% to -0.2% in the quarter
- Industrial production fell -1.0% m/m; machine orders rose 10.7% m/m; retail sales fell -2.5% m/m; consumer confidence rose 1.1 to 42.6; the composite PMI was unchanged at 52.3; the Economy Watchers survey current reading fell -0.9 to 46.1; the outlook reading fell -0.9 to 48.2; bank lending growth slowed to 2.3% y/y from 2.5% y/y; the tertiary index rose 0.9% m/m; CPI rose 0.3% y/y; core CPI ex fresh food and energy rose 1.2% y/y
- The Bank of Japan (BoJ) left the level of total asset purchases unchanged at Y80trn pa. There were a number of technical adjustments such as changes to maturities of bonds purchased and buying of ETF's targeted at companies which increase investment. The BoJ stated these were aimed at improving the efficiency and transmission of policy measures. The BoJ still believes inflation will rise towards the target 2% and the economy will continue to improve moderately

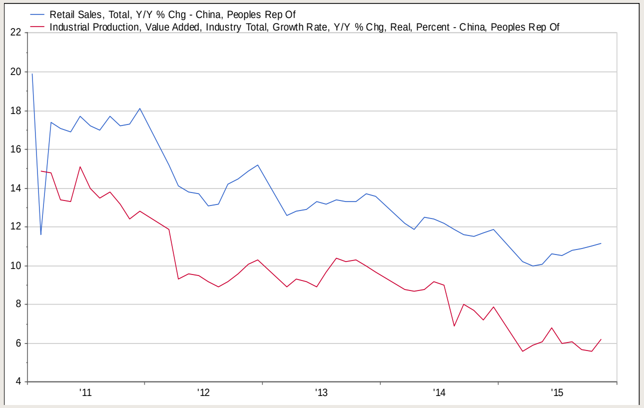
## Chinese Economy

- Chinese data generally continued to show signs of stabilisation
- Exports fell -6.8% y/y from -6.9%; imports fell -8.7% y/y from -18.8% previously
- Retail sales growth improved to 11.2% y/y from 11.0%; industrial production growth improved to 6.2% y/y from 5.6%; fixed asset investment growth was unchanged at 10.2% y/y
- Industrial profits fell -1.4% y/y from -4.6% previously
- Monthly new lending rose Rmb 195.3bn to Rmb 708.9bn
- The Caixin manufacturing PMI rose 0.3 to 48.6; services fell -0.8 to 51.2; the composite PMI rose 0.6 to 50.5. Official manufacturing PMI slipped -0.2 to 49.6; services rose 0.5 to 53.6

### Japanese GDP Revised Back to Positive Growth




### Chinese Economic Data Stabilises



Irish Life Investment Managers Limited is regulated by the Central Bank of Ireland

Past performance and forecasts may not be a reliable guide to future performance.

Investments may fall as well as rise.

Changes in currency exchange rates may have an adverse effect on the value, price or income of the product.

This material is for information only and does not constitute an offer or recommendation to buy or sell any investment and has not been prepared based on the financial needs or objectives of any particular person. It is intended for the use of institutional and other professional investors

**Irish Life Investment Managers**
**Beresford Court**
**Beresford Place**
**Dublin 1**

**Tel (01) 704 1200**
**Fax (01) 704 1918**
**Web: www.ilim.com**